

Message Text

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INFO OCT-01 ISO-00 CIAE-00 DODE-00 PM-05 H-01 INR-10
L-03 NSAE-00 NSC-05 PA-01 SP-02 SS-15 USIA-06
AID-05 COME-00 EB-08 FRB-03 TRSE-00 XMB-02
OPIC-03 LAB-04 SIL-01 OMB-01 /088 W
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R 031046Z MAR 78
FM AMEMBASSY MADRID
TO SECSTATE WASHDC 3676
INFO AMEMBASSY BRUSSELS
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AMEMBASSY PARIS

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USOECD AND USEEC

E.O. N/A
TAGS: PINT, ECON, SP
SUBJECT: NEW SPANISH ECONOMIC LEADERSHIP NOT EXPECTED
TO ABANDON AUSTERITY MEASURES

REF: MADRID 2036; MADRID 2027

1. SUMMARY: ALTHOUGH FUENTES QUINTANA, THE ARCHITECT OF THE SPANISH PROGRAM FOR AUSTERITY AND STRUCTURAL REFORMS, HAS RESIGNED AS SECOND VICE PRESIDENT (SEE REFTELS) HIS POLICIES WILL BY-AND-LARGE BE CONTINUED. IN PARTICULAR THE KEY AUSTERITY MEASURES -A SLOWER GROWTH OF THE MONEY SUPPLY AND RESTRAINTS ON WAGE INCREASES- ARE NOT LIKELY TO BE ALTERED. THE NEW ECONOMIC LEADERSHIP IS EXPECTED TO HAVE A DIFFERENT POLITICAL STYLE, AND WILL PROBABLY BE LESS TOUGH-MINDED IN THE AREAS OF STRUCTURAL REFORM AND FISCAL POLICY. END SUMMARY.

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2. THE RESIGNATION OF PROFESSOR FUENTES QUINTANA AS SECOND VICE PRESIDENT AND THE NAMING OF A NON-ECONOMIST REPLACEMENT RAISE STILL-DIFFICULT-TO-ANSWER QUESTIONS ABOUT POSSIBLE CHANGES IN THE SPANISH APPROACH FOR TREATING THE AILING ECONOMY. AT THIS POINT THE FUENTES ECONOMIC POLICIES ARE INTACT, FUENTES HIMSELF RETAINS AN UNDEFINED POLICY ROLE IN HIS NEW POSITION AS PRESI-

DENTIAL ADVISOR, AND THE MINISTRY OF ECONOMY HE CREATED LAST SUMMER HAS SURVIVED, TOGETHER WITH SOME OF THE ORIGINAL FUENTES APPOINTEES. MOST IMPORTANT OF ALL, SPAIN'S PARLIAMENTARY GROUPINGS REMAIN COMMITTED TO THE MONCLOA PACT, WHICH SPELLS OUT AGREED ECONOMIC POLICIES FOR THIS YEAR. CONSEQUENTLY IT IS AT BEST PREMATURE TO SPEAK OF MAJOR POLICY SHIFTS. STILL, THERE IS A GENERAL EXPECTATION THAT WITH THE NEW ECONOMIC LEADERSHIP WILL NECESSARILY COME NEW PRIORITIES. WE BELIEVE THAT THE MOST LIKELY CHANGES WILL BE: 1) A MORE POLITICAL STYLE OF ECONOMIC LEADERSHIP, 2) KINDER WORDS AND PROBABLY MORE ACCOMODATING POLICIES FOR BUSINESSMEN, AND 3) A SLOWDOWN IN THE PACE OF STRUCTURAL REFORMS AND A LIKELY, PARTLY INVOLUNTARY, EASING OF FISCAL POLICY.

3. THE ECONOMIC POLICIES NOW BEING PURSUED (SEE MADRID A-1) ARE ANCHORED IN LAST FALL'S MONCLOA PACT. THE KEY TO SPAIN'S RECENT SUCCESS IN REDUCING THE RAGING INFLATION EXPERIENCED LAST SUMMER AND FALL IS THE USE OF A SLOWER RATE OF GROWTH FOR THE MONEY SUPPLY (THE PACT SPECIFIES A 17 PERCENT INCREASE IN THE M3 MEASURE DURING 1978) COMBINED WITH A CEILING ON WAGES (WHICH THE PACT SETS AT A 22 PERCENT YEAR-OVER-YEAR GROWTH IN TOTAL ENTERPRISE SALARY COSTS). SEVERAL OF THE NEW CABINET MEMBERS HAVE ALREADY PUBLICLY VOWED ADHERENCE TO THE MONCLOA PACT, AND WE CONSIDER IT UNLIKELY THAT THE SUAREZ LIMITED OFFICIAL USE

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GOVERNMENT WILL ABANDON THE PACT'S CRUCIAL MONETARY AND INCOMES POLICIES IN THE NEAR FUTURE.

4. THERE MAY, HOWEVER, BE A SLOWER PACE FOR STRUCTURAL REFORMS AND A MORE EXPANSIONARY FISCAL POLICY. THE STRUCTURAL REFORMS, WHILE UNQUESTIONABLY IMPORTANT, ARE POLITICALLY AND TECHNICALLY DIFFICULT TO EXECUTE AND ARE SLOWER TO BRING ECONOMIC BENEFITS. THE MAJOR REFORMS -A MORE MARKET-ORIENTED FINANCIAL SYSTEM AND A MODERNIZED TAX SYSTEM- ARE ALREADY UNDERWAY. MORE LIABLE TO BE SCALED DOWN ARE THE PROJECTS FOR A NEW NATIONAL ENERGY PLAN AND REFORMS FOR PUBLIC SECTOR ENTERPRISES. BOTH OF THESE AREAS ARE SO THORNY THAT THEY CONTRIBUTED TO THE DISSATISFACTION THAT LED FUENTES QUINTANA TO RESIGN. THE GOVERNMENT ALSO MAY NOT IMMEDIATELY CARRY OUT ITS PLANS TO ALLOW FOREIGN (INCLUDING U.S.) BANKS TO OPEN BRANCHES HERE, BECAUSE IT MAY DOUBT THAT THE BENEFITS ARE WORTH THE IRE OF THE DOMESTIC BANKS.

5. EVEN WITH THE BEST OF INTENTIONS IT IS DOUBTFUL THAT THE GOVERNMENT CAN OR WILL ACHIEVE ALL OF THE MONCLOA PACT'S FISCAL GOALS. IN MADRID A-40 WE SHOW THE 1978 BUDGET WILL BE LARGER THAN THE 73 BILLION PESETAS AGREED

TO IN THE PACT, AND THAT IT CANNOT BE EXPECTED THAT SOCIAL SECURITY EXPENDITURES WILL BE FINANCED BY BUSINESS CONTRIBUTIONS TO THE EXTENT REQUIRED BY THE PACT. IN SPITE OF SUCH PROBLEMS, AND THE PERSISTENT CONTROVERSY SURROUNDING MASSIVE LOSSES BY SOME PUBLIC ENTERPRISES, FISCAL QUESTIONS REMAIN LESS CONTROVERSIAL THAN WAGE RESTRAINTS AND THE MONEY SUPPLY. WE SUSPECT THAT A SOMEWHAT MORE EXPANSIONARY FISCAL POLICY MAY EVEN BE DELIBERATELY RESORTED TO IF THE GOVERNMENT DECIDES TO EASE UP ON AUSTERITY.

6. THE NEW ECONOMIC LEADERSHIP ALMOST SURELY ASPIRES TO

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IMPROVE RELATIONS WITH SPANISH BUSINESSMEN, FOR THE POLITICAL AND ECONOMIC REWARDS THAT THIS COULD BRING. AS VICE PRESIDENT, FUENTES QUINTANA ESTABLISHED A HIGH PROFILE IN AREAS WHERE THIS DID NOT SEEM NECESSARY, CONSISTENTLY MAINTAINING THAT IN THE SHORT RUN HIS AUSTERITY PROGRAM UNAVOIDABLY REQUIRED LOWER BUSINESS PROFITS, A LOWER LEVEL OF INVESTMENT AND INCREASED BANKRUPTCIES. ALTHOUGH A RECENT SURVEY SHOWED THAT BUSINESSMEN STILL RESPECTED FUENTES MORE THAN OTHER MINISTERS WITH ECONOMIC RESPONSIBILITIES -AND MORE THAN PRIME MINISTER SUAREZ- SUCH UNCOMPROMISING PUBLIC STATEMENTS DISPLEASED MANY ENTREPRENEURS. BUSINESSMEN HAVE BEEN

ESPECIALLY INSISTENT IN ASKING FOR A LESS RESTRICTIVE
MONETARY POLICY AND MORE FREEDOM TO HIRE AND FIRE WORKERS.
WHILE WE DO NOT FORESEE A LESS RESTRICTIVE MONETARY POLICY
THERE MAY NOW BE SOME GOVERNMENT ACTION TO HELP FIRMS
FACING BANKRUPTCY. LABOR REFORMS WILL COME, BUT THE
QUESTION IS STILL HOW MUCH AND HOW SOON. STABLER
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